

2979

No. 15207

**United States
Court of Appeals**
for the Ninth Circuit

C. H. WENTWORTH,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

Transcript of Record

**Petition to Review a Decision of the Tax Court
of the United States**

FILED

OCT 2 1956

No. 15207

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for the Ninth Circuit

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[Clerk's Note: When deemed likely to be of an important nature, errors or doubtful matters appearing in the original certified record are printed literally in *italic*; and, likewise, cancelled matter appearing in the original certified record is printed and cancelled herein accordingly. When possible, an omission from the text is indicated by printing in *italic* the two words between which the omission seems to occur.]

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APPEARANCES

For Petitioner:

ERIC L. BURTON, Esq.

For Respondent:

MARK TOWNSEND, Esq.

DOCKET ENTRIES

1953

Nov. 16—Petition received and filed. Taxpayer notified. Fee paid.

Nov. 17—Copy of petition served on General Counsel.

Nov. 16—Request for Circuit hearing in Los Angeles filed by taxpayer. 11/30/53, granted.

1954

Jan. 6—Answer filed by General Counsel.

Jan. 12—Copy of answer served on taxpayer, Los Angeles.

1955

Feb. 8—Hearing set Apr. 25, 1955, Los Angeles.

Apr. 25—Hearing had before Judge Turner on merits. Stipulation of Facts filed at hearing. Briefs due 90 days from April 25, 1955; replies due 120 days from Apr. 25, 1955.

May 4—Transcript of Hearing 4/25/55 filed.

July 5—Brief filed by taxpayer. 7/26/55, copy served.

July 25—Brief filed by General Counsel.

Aug. 23—Reply brief filed by taxpayer. Copy served 8/24/55.

1956

Mar. 12—Opinion filed. Decision will be entered for the respondent. Copy served 3/13/56.

Mar. 14—Decision entered, Judge Mulroney, Div. 9.

June 7—Petition for review by U. S. Court of Appeals, Ninth Circuit, filed by petitioner.

June 13—Proof of service filed.

1956

June 12—Designation of Contents of Record on Review filed.

June 12—Affidavit of service by mail of petition for review filed.

June 12—Affidavit of service by mail of Designation of Contents of Record on Review filed.

June 14—Proof of service of designation of contents of record on review filed.

The Tax Court of the United States

Docket No. 51260

C. H. WENTWORTH,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

PETITION

The above-named petitioner hereby petitions for a redetermination of the deficiency set forth by the office of the Commissioner of Internal Revenue in his notice of deficiency designated by reference ARC-AP-SF LA-90D-DRR, Regional Office of the Appellate Division, Los Angeles, California, dated August 24, 1953, and as a basis of his proceeding alleges as follows:

1. The petitioner is an individual with principal office at 1700 East Olympic Boulevard, Los Angeles

22, California. The return for the period here involved was filed with the Collector of Internal Revenue for the 6th district of California.

2. The notice of deficiency (a copy of which is attached and marked Exhibit "A") was mailed to the petitioner on August 24, 1953.

3. The deficiency as determined by the Commissioner is in income taxes for the calendar year 1947 in the amount of Sixty Thousand Nine Hundred Two and 38/100 Dollars (\$60,902.38), of which Sixty Thousand Nine Hundred Two and 38/100 Dollars (\$60,902.38) is in dispute.

4. The determination of tax set forth in the said notice of deficiency is based upon the following errors:

a) In determining the deficiency in income tax for the calendar year 1947, the Commissioner has erroneously included as taxable dividends the sum of Eighty-Two Thousand Five Hundred Twenty-two and 06/100 Dollars (\$82,522.06).

5. The facts upon which the petitioner relies as the basis of this proceeding are as follows:

a) That the said sum of Eighty-two Thousand Five Hundred Twenty-two and 06/100 Dollars (\$82,522.06) was part of a Two Hundred Thousand Dollars (\$200,000.00) payment from the Flexo Manufacturing Company, Inc., to taxpayer; said Two Hundred Thousand Dollars (\$200,000.00) being payment in full of notes of said company held by taxpayer.

Wherefore, the petitioner prays that this Court may hear the proceeding and determine that the deficiency due from the petitioned for the year 1947 should not be in excess of none.

/s/ ERIC L. BURTON,
Counsel for Petitioner.

Duly verified.

EXHIBIT A

Regional

1250 Subway Terminal Building
417 S. Hill Street,
Los Angeles 3 Calif.

ARC-AP-SF
LA-90D-DRR

August 24, 1953.

Mr. C. H. Wentworth,
1700 E. Olympic Blvd.,
Los Angeles 21, Calif.

Dear Mr. Wentworth:

You are advised that the determination of your income tax liability for the taxable year ended December 31, 1947, disclosed a deficiency of \$60,902.38 as shown in the statement attached.

In accordance with the provisions of existing internal revenue laws, notice is hereby given of the deficiency mentioned.

Within 90 days from the date of the mailing of this letter you may file a petition with the Tax

Court of the United States, at its principal address, Washington, 4 D. C. for a redetermination of the deficiency. In counting the 90 days you may not exclude any day unless the 90th day is a Saturday, Sunday or legal holiday in the District of Columbia in which event that day is not counted as the 90th day. Otherwise Saturday, Sundays and legal holidays are to be counted in computing the 90th-day period.

Should you not desire to file a petition, you are requested to execute the enclosed form, in duplicate, and forward it to the Assistant Regional Commissioner, Appellate, 1250 Subway Terminal Building, 417 S. Hill Street, Los Angeles, 13, California. The signing and filing of this form will expedite the closing of your return by permitting an early assessment of the deficiency, and will prevent the accumulation of interest, since the interest period terminates 30 days after receipt of the form, or on the date of assessment, or on the date of payment, whichever is earlier.

Yours very truly,

T. COLEMAN ANDREWS,
Commissioner of Internal
Revenue,

By W. T. TIGNOR,
Associate Chief, Appellate.

Enclosures;
Statement,
Form 1276,
Agreement form.

C. H. Wentworth vs.

Statement

C. H. Wentworth
1700 East Olympic Blvd.
Los Angeles 21, Calif.

Tax Liability for the Taxable Year Ended
December 31, 1947

Income Tax	
Year	Deficiency
1947	\$60,902.38

In making this determination careful consideration has been given to the report of examination dated May 6, 1952, to your protest dated September 8, 1952, and to the statements made at the hearing held on December 17, 1952.

A copy of this letter and a copy of the statement have been mailed to your representative, Mr. Clarence W. Horn, 905 W. I. Hollingsworth Bldg., 606 S. Hill St., Los Angeles 14, Calif., in accordance with the authority contained in the power of attorney executed by you.

Adjustment to Net Income

Taxable Year Ended December 31, 1947

Net income as disclosed by amended return.....	\$ 26,310.46
Additional income:	
(a) Dividends increased	82,522.06
Net income as adjusted.....	<u>\$108,832.52</u>

Explanation of Adjustment

(a) During the year 1947 you received a payment in the amount of \$200,000.00 from the Flexo Manufacturing Company, Inc., of which you are the major stockholder. No part of the above payment received by you was reported as income in your 1947 income tax return. It is determined that of the \$200,000.00 payment received, the sum of \$82,522.06 represents a taxable dividend reportable as income for the year 1947.

Computation of Tax

Taxable Year Ended December 31, 1947

Net income as adjusted.....	\$108,832.52
Less: Exemption	500.00
<hr/>	
Amount subject to tentative tax.....	\$108,332.52
Tentative tax	\$ 74,735.94
Less: 5% of tentative tax.....	3,736.80
<hr/>	
Combined normal tax and surtax.....	\$ 70,999.14
Correct income tax liability.....	\$ 70,999.14
Income tax liability shown on amended return, Account No. 900549, 6th California District.....	10,096.76
<hr/>	
Deficiency of income tax.....	\$ 60,902.38

Received and filed November 16, 1953, T.C.U.S.

Served November 17, 1953.

[Title of Tax Court and Cause.]

REQUEST FOR DESIGNATION OF
PLACE OF HEARING

Comes now C. H. Wentworth by his attorney, Eric L. Burton, and in accordance with Rule 26 of Rules of Practice Before the Tax Court of the United States requests that the Court designate that the hearing in the above-entitled proceeding be at Los Angeles, California.

/s/ ERIC L. BURTON,

Counsel for Petitioners.

Received and filed November 16, 1955, T. C. U. S.

Granted November 30, 1953.

Served December 1, 1953.

[Title of Tax Court and Cause.]

ANSWER

The Commissioner of Internal Revenue, by his attorney, Daniel A. Taylor, Chief Counsel, Internal Revenue Service, for answer to the petition of the above-named taxpayer, admits, denies and alleges as follows:

1, 2 and 3. Admits the allegations contained in paragraphs 1, 2 and 3 of the petition.

4. Denies the allegations of error contained in paragraph 4 of the petition and the subparagraph thereof.

5. Denies the allegations contained in paragraph 5 of the petition and the subparagraph thereof.

6. Denies generally and specifically each and every allegation contained in the petition not hereinbefore expressly admitted, qualified or denied.

Wherefore, it is prayed that the petitioner's appeal be denied and that the Commissioner's determination be approved.

/s/ DANIEL A. TAYLOR, R.E.M.

Chief Counsel,

Internal Revenue Service.

Filed January 6, 1954.

[Title of Tax Court and Cause.]

STIPULATION OF FACTS

It is hereby stipulated and agreed, by and between the parties hereto, by their respective counsel, that the following facts are true; provided however, that this stipulation shall be without prejudice to the right of either party to introduce other and further evidence not inconsistent with the facts herein stipulated to be taken as true:

1. Attached hereto and marked Joint Exhibit 1-A and 2-B are respectively the original and amended individual income tax returns filed by the petitioner for the taxable year 1947.

2. On January 1, 1953, petitioner transferred the following assets, shown at cost, to the Flexo Manufacturing Company, Inc., a newly formed corporation, in exchange for capital stock:

Cash in Bank	\$ 12,704.63
Accounts Receivable	105,922.97
Inventory	55,685.71
Furniture	286.67
Machinery and Equipment	18,073.64
Auto and Equipment.....	3,235.30

The foregoing assets were substantially all of the assets of the sole proprietorship business carried on by taxpayer under the firm name and style of Flexo Manufacturing Company.

The following liabilities and reserves were also transferred by taxpayer to said corporation:

Accounts Payable	\$10,793.54
Reserve for Federal Old Age Benefits Tax	272.40
Reserve for Federal Payroll Excise Tax..	108.40
Reserve for California Unemployment Insurance Tax	503.83
California Sales Tax	6.10
Notes Payable	4,500.00
Bonus Payable	11,371.18
Reserve for Bad Debts.....	4,544.49
Reserve for Depreciation Machinery and Equipment	7,836.81
Reserve for Depreciation Autos and Equipment	3,235.30

The foregoing transfers resulted in a capital contribution to said corporation, on a book basis, in the amount of \$152,737.44.

3. In exchange for the transfer, the petitioner received 120,830 shares of capital stock, par value, \$1.00 per share, issued September 26, 1944. He transferred five qualifying shares to Robert Steele and 4,167 shares were sold by the corporation to Lloyd Wallmer for cash, resulting in a total issuance of 124,997 shares by the corporation.

4. Petitioner maintained an open account in his name on the books of the corporation styled "Accounts Receivable—C. H. Wentworth."

Attached hereto and marked Joint Exhibit 3-C is a true copy of such account as shown on the books of the corporation for the years 1943 and 1944. As of February 27, 1943, this account had a credit bal-

ance of \$2,197.20. On the same date, petitioner advanced the corporation \$100,000 and received a note bearing six per cent interest due in one year. On April 14, 1943, the petitioner's open account reflected a credit balance of \$3,397.20 and on the same date, the petitioner advanced the corporation an additional \$100,000 and received an additional note bearing six per cent interest due in one year. Both notes were carried on the corporation books as "notes payable." As of December 31, 1943, the petitioner's open account reflected a debit balance in the amount of \$197,211.03. Attached hereto and marked Joint Exhibit 4-D is a true copy of the balance sheet of the corporation as of December 31, 1943.

5. On October 31, 1944, the petitioner's open account reflected a debit balance of \$200,742.60. On the same date, the corporation credited the open account with \$180,000, leaving a debit balance in the account of \$20,742.60, and charged a like amount to its capital account with a resultant capital deficit of \$23,095.56. No charge or entry was made to the notes payable account to petitioner and said notes in the amount of \$200,000 were not canceled. Attached hereto and marked Joint Exhibit 5-E is a condensed balance sheet of the corporation as of December 31, 1944.

6. No income was reported by the petitioner on his individual income tax returns as resulting from the credit by the corporation to his open account of

\$180,000, nor was any stock exchanged or surrendered by the petitioner.

7. In May, 1947, the corporation paid the petitioner the sum of \$200,000 at which time the notes were still in the possession of the petitioner and were, upon such payment, surrendered to the corporation and canceled. The accounting records of the corporation, prior to the payment, reflected notes payable to the petitioner in the amount of \$200,000 until the payment in May, 1947; at which time said payment was offset against the notes payable account on the books of the corporation.

8. Attached hereto and marked Joint Exhibits 6-F, 7-G, 8-H, 9-I and 10-J are true copies of the form 1120's filed by the corporation for the taxable years 1943, 1944, 1945, 1946 and 1947, respectively. No dividends have been declared by the corporation since its formation in January 31, 1943, through the period here involved. As of December 31, 1947, the corporation had earned surplus available for distribution in the amount of \$82,522.06.

/s/ ERIC L. BURTON,
Counsel for Petitioner.

/s/ R. P. HERTZOG,
Acting Chief Counsel, Internal Revenue Service,
Counsel for Respondent.

Filed at hearing April 25, 1955, T.C.U.S.

[Title of Tax Court and Cause.]

FINDINGS OF FACT AND OPINION

Filed March 12, 1956

A corporation in 1944 credited the accounts receivable account of its controlling stockholder for \$180,000, and debited its capital account for the same amount. Earned surplus at the end of that year was \$171,920.38. The corporation was indebted to the stockholder on two \$100,000 notes, overdue and payable at the time the particular credit was made. Held, under these circumstances the credit to the accounts receivable account in 1944 worked a corresponding offset in the notes payable account, and a corporate distribution of \$200,000 in 1947 was a taxable dividend to the extent of earnings and profits in that year, and not, as the stockholder contends, a payment by the corporation on the note indebtedness to him.

ERIC L. BURTON, ESQ.,

For the Petitioner.

MARK TOWNSEND, ESQ.,

For the Respondent.

OPINION

Mulroney, Judge.

The respondent determined a deficiency in income tax for the calendar year 1947 in the amount of \$60,902.38. The only issue is whether a distribu-

tion of \$200,000 in 1947 to the petitioner by a corporation, in which he was the controlling stockholder, was a taxable dividend to the extent of earnings and profits or a repayment of a loan, evidenced by notes, made by the petitioner to the corporation in prior years. All of the facts are stipulated and are now found accordingly.

The petitioner is an individual with a principal office at 1700 East Olympic Boulevard, Los Angeles, California. His original and amended income tax returns for the calendar year 1947 were filed with the then collector of internal revenue for the sixth district of California.

On January 1, 1943, the petitioner transferred to a newly formed corporation, the Flexo Manufacturing Company, Inc., (hereinafter called "corporation"), substantially all of the assets of a sole proprietorship business carried on by the petitioner under the firm name of Flexo Manufacturing Company. The assets so transferred were as follows, shown at cost:

Cash in Bank	\$ 12,704.63
Accounts Receivable	105,922.97
Inventory	55,685.71
Furniture	286.67
Machinery and Equipment	18,073.64
Auto and Equipment	3,235.30

The following liabilities and reserves were also transferred by the petitioner to the newly formed corporation:

Accounts Payable	\$10,793.54
Reserve for Federal Old Age Benefits Tax	272.40
Reserve for Federal Payroll Excise Tax	108.40
Reserve for California Unemployment Insurance Tax	503.83
California Sales Tax	6.10
Notes Payable	4,500.00
Bonus Payable	11,371.18
Reserve for Bad Debts	4,544.49
Reserve for Depreciation Machinery and Equipment	7,836.81
Reserve for Depreciation Autos and Equipment	3,235.30

The transfers of the assets, liabilities, and reserves by the petitioner to the corporation resulted in a capital contribution to such corporation, on a book basis, in the amount of \$152,737.44.

The petitioner received from the corporation, in exchange for the transfer, 120,830 shares of stock with a par value of \$1 per share, of which he transferred five qualifying shares to Robert Steele. The stock was issued on September 26, 1944. The corporation sold 4,167 shares of stock for cash to Lloyd Wallmer, making a total of 124,997 shares of stock outstanding.

An open account in petitioner's name was maintained on the books of the corporation with the heading "Accounts Receivable—C. H. Wentworth." On February 27, 1943, this account had a credit balance of \$2,197.20. On that same date the petitioner advanced \$100,000 to the corporation and received

a note in the face amount of \$100,000, maturing in one year and bearing 6 per cent interest. On April 14, 1943, the open account had a credit balance of \$3,397.20, and on the same date the petitioner advanced an additional \$100,000 to the corporation, receiving back an additional note in the face amount of \$100,000, also maturing in one year and bearing interest at 6 per cent. Both notes were carried on the corporate books as "notes payable." On December 31, 1943, the open account on the corporation's books in the petitioner's name reflected a debit balance of \$197,211.03.

On October 31, 1944, the petitioner's open account had a debit balance of \$200,742.60. The corporation on that date credited the open account with \$180,000, leaving a debit balance in the account of \$20,742.60, and at the same time charged its capital account, which resulted in a capital deficit of \$23,095.56. No charge or entry was made to the notes payable account, nor were the notes payable in the amount of \$200,000 canceled.

No income was reported by the petitioner on his individual income tax return for the calendar year 1944, or for any other year, as resulting from the credit of \$180,000 made by the corporation to his open account. The petitioner did not exchange any stock with the corporation or surrender any stock to the corporation, nor has there been any liquidation or partial liquidation of the corporation.

On December 31, 1943, the earned surplus account of the corporation showed a credit balance of

\$114,322.19, and on December 31, 1944, the credit balance in this account was \$171,920.38. The earned surplus of the corporation, on December 31, 1947, was \$82,522.06.

In May, 1947, the corporation distributed to the petitioner the sum of \$200,000. At the same time, the petitioner surrendered to the corporation the two notes of the corporation made out in 1943 and maturing in 1944. The notes payable account on the corporation's books was debited with the amount of \$200,000, and the notes were cancelled.

The ultimate question in this case is whether part of the note indebtedness was paid in years prior to 1947. The parties to the notes were the corporation, payor, and the petitioner, payee, but the payee completely controlled and dominated the payor. It is worth consideration that petitioner at all times had the power to cast any transaction with the corporation in a form most favorable to him. The basic question of whether the notes were partly paid in prior years is one of fact—what the parties actually did in those prior years. Bookkeeping is the recording of action taken so, ordinarily, the bookkeeping entry establishes the fact of the action taken. But bookkeeping entries are not conclusive. *Helvering v. Midland Mutual Life Insurance Co.*, 300 U.S. 216. The evidentiary value of a bookkeeping entry is further weakened when it obviously is one that is strange to accepted bookkeeping practice.

The Commissioner had a right to examine the actions of the parties to the notes for any year after they were executed to see if in fact the note indebtedness was partly paid. Here he examines the actions of the parties to the notes in the year 1944 at a time when, admittedly, the payor of the notes paid the payee, petitioner, \$180,000. This he had a right to do and petitioner's argument that he is opening up a year that is barred by the statute of limitations is without merit. The commissioner is not seeking to tax petitioner with any income he might have received that year. He is merely examining a transaction that occurred that year to see whether or not it resulted in payment of part of the note indebtedness.

The whole case comes down to the effect that is to given to the transaction of October 31, 1944, whereby the corporation credited taxpayer's open account with \$180,000. The petitioner here asserts this \$180,000 credit was, to the extent of the payment out of earned surplus (\$171,920.38), a dividend distribution to him. The respondent asserts it was a credit on the corporation's note indebtedness of \$200,000 to petitioner. The determination as to who is right with respect to this 1944 transaction will decide the case. If the petitioner is right then the 1947 payment to him of \$200,000 merely repaid his loan. If the respondent is right, the \$200,000 loan was paid down to \$20,000 by the \$180,000 credit in 1944, so the 1947 payment of \$200,000 was, to the extent of the earned surplus (\$82,522.06), income.

Petitioner argues he and the corporation "elected to treat said charge of said \$180,000, as a return of capital" though he admits such treatment would result in the payment of a taxable dividend to him under section 115 of the Internal Revenue Code of 1939. Respondent argues it was "obviously erroneous" to charge the capital account with this \$180,000 credit payment; that such an offsetting entry in the capital account would have been proper only if it represented redemption of stock or was the result of a liquidation or partial liquidation of the corporation. Petitioner admits there was no cancellation of stock or planned liquidation involved and he does not seem to defend the offsetting entry in the capital account as being proper under good accounting practice. He admits the \$180,000 credit had to be treated as a distribution of earned surplus to him or as a payment on his notes. He argues it cannot be treated as payment on the notes because no offsetting entry was made in the note account. His argument is it was the distribution of earned surplus to him, or, in other words, a dividend distribution.

Since the offsetting entry—the debit to the capital account—does not clearly reflect what actually occurred, we have a right to look at other facts, and the actions of the parties to the note obligations. Petitioner asserts the credit was a dividend distribution. But this corporation, almost wholly-owned and controlled by petitioner, had never declared any dividends. There was another stock-

holder holding 4,167 shares, who received nothing if the major portion of the \$180,000 credit is called a dividend. While there is no need that a dividend distribution be pro rata among stockholders, the fact that a payment is made to one and not the others militates against its being called a dividend when it can fairly be explained it is not.

Both of the \$100,000 notes were past due at the time the \$180,000 credit was made. These two notes appear to be the corporation's only indebtedness to petitioner. In any controversy between the parties to the notes there would be a presumption that any payment by the payor to the payee was to apply on the outstanding indebtedness.

Now let us look at the actions of the payee, the petitioner, at the time he received this \$180,000 credit from the payor of the notes. Do his actions show he treated it as a distribution of dividends? Clearly they do not. He did not report it as dividend income in his income tax return for 1944. All of his actions are consistent with the receipt of the \$180,000 as payment on his notes and inconsistent with his treatment of the payment as income to him.

In *Crane v. Commissioner*, 68 F. 2d 640, there was involved the right of the taxpayer to the benefit of an expenditure made by his lessee when the taxpayer failed to report or to pay a tax in the appropriate year or years upon income received by virtue of the lessee's expenditure. In the course of the opinion, it is stated:

This obligation to report and pay a tax was never performed, and cannot now be enforced against the petitioner, because it is barred by the statute of limitations. The petitioner urges that he is entitled to the benefit of the statute of limitations, and so he is. The obligation can no longer be enforced. But the failure, however innocent, to report this income, constituted in effect a statement that no such income was received, * * *.

As stated earlier, we have a right to consider the fact that petitioner was the president of and controlled the corporation. If he had wanted the books to show a dividend payment to him he could have caused the books to show the usual entries that record distribution of dividends. We are not so naive as to think petitioner would ever claim the unclear book entries show a dividend distribution to him, were it not for the fact the income tax on such distribution is now barred.

There is nothing in the record to show petitioner was unfamiliar with the income tax laws. Presumably he paid income tax on the earnings of his business in the years prior to 1943. He in effect incorporated his going business in 1943 and he wants us to conclude the next year he took \$171,920.38 worth of earnings from his business and paid no tax. We only treat the \$180,000 credit as he, by his actions, showed he treated it when we hold it was payment on the notes and not a taxable transaction.

Under all of the special facts of this case we find the petitioner did receive payment on his

notes in the sum of \$180,000 on October 31, 1944. Therefore the distribution of \$200,000 in 1947 to the petitioner resulted in a taxable dividend to him of \$82,522.06, the amount of the corporation's earnings and profits at the end of that year.

Reviewed by the Court.

Decision will be entered for the respondent.

Murdock, J., dissenting.

Labored reasoning is used in the prevailing opinion to bail out the Commissioner after the statute of limitations has run against an earlier year in which he should have taken the action which he is now taking. The courts have held repeatedly against that. *Ross v. Commissioner*, 169 F. 2d 483; *Commission v. Dwyer*, 203 F. 2d 522, 524; *Richard K. Mellon*, 12 T.C. 90, 110; *American Light & Traction Co.*, 42 B.T.A. 1121, *affd.* 125 F. 2d 365; *Tide Water Oil Co.*, 29 B.T.A. 1208; *James Couzens*, 11 B.T.A. 1040.

The petitioner advanced \$200,00 to the corporation, received the notes of the corporation for that amount and held those notes until the corporation repaid him \$200,000 in 1947, at which time the notes were canceled. Thus in form and in the accounting by the corporation these were bona fide loans which were paid off in 1947. The question then would be what justification is there for disregarding the form of these transaction to hold that the substance was entirely different. The corporation carried a per-

sonal account on its books under the petitioner's name which at times had a credit balance and at other times had a debit balance. The debit balance in 1944 was slightly in excess of \$200,000. The corporation at that time credited \$180,000 to that account of the petitioner on its books and at the same time debited capital. The opinion holds contrary to the evidence, that the \$180,000 was a payment on the notes. The Commissioner, if he had any doubt about that crediting, should have held for that year that it was the equivalent of the distribution of a taxable dividend. He would undoubtedly prefer that position if both years were open, for in that year the earnings available for a dividend were far in excess of the earnings available in 1947. The petitioner's failure to report the taxable dividend for 1944 was not a misrepresentation, since at most that would have been his own interpretation of the law. *Commissioner v. American Light & Traction Co.*, *supra*; *Ross v. Commissioner*, *supra*. We should not hold that there was a distribution of a taxable dividend in 1947 merely because the Commissioner now finds it too late to go back to 1944.

Served March 13, 1956.

The Tax Court of the United States
Washington

Docket No. 51260

C. H. WENTWORTH,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

DECISION

Pursuant to the determination of the Court, as set forth in its Opinion, filed March 12, 1956, it is

Ordered and Decided: That there is a deficiency in income tax of \$60,902.38 for the calendar year 1947.

/s/ JOHN E. MULRONEY,
Judge.

[Entered]: March 14, 1956.

Served March 16, 1956.

In the United States Court of Appeals
for the Ninth Circuit

T. C. Docket No. 51260

C. H. WENTWORTH,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

PETITION FOR REVIEW

Taxpayer, the petitioner in this cause, C. H. Wentworth, by Eric L. Burton, Counsel, hereby files his petition for a review by the United States Court of Appeals for the Ninth Circuit of the decision by the Tax Court of the United States rendered on March 14, 1956, 25 T. C. No. 139, determining a deficiency in petitioner's Federal income tax for the calendar year 1947 in the amount of \$60,902.38, and respectfully shows:

I.

Statement of Facts

1. The tax return in question was filed in California and petitioner resides and all of the facts involved in this case occurred within said State; the case was heard in Los Angeles, California.

2. On January 1, 1943, petitioner transferred assets, having a book value of \$152,737.44, to the corporation in exchange for its capital stock. Said

net assets were substantially all the assets of a sole proprietorship business theretofore carried on by petitioner under the firm name and style of Flexo Manufacturing Co.

3. Petitioner maintained an open account on the books of the corporation to which were charged against him any amounts paid to petitioner or to third parties for the account of the petitioner. On December 31, 1943, on this open account, petitioner was indebted to the corporation in the amount of \$197,211.03. On October 31, 1944, petitioner was indebted to the corporation on said open account in the sum of \$200,742.60.

4. As of February 27, 1943, the petitioner advanced to the corporation the sum of \$100,000.00 and received from the corporation its promissory note in the amount of \$100,000.00, bearing interest at the rate of 6% per annum. On April 14, 1943, the petitioner advanced the corporation an additional \$100,000.00 and received another promissory note for this amount bearing interest at the rate of 6% per annum. Both notes were carried on the corporation's books at Notes Payable, in a separate account, this note payable account was distinct and separate from petitioner's "Open Account."

5. On October 31, 1944, on the accounting records of the corporation, petitioner's open account was credited with \$180,000.00, leaving a balance owing to the corporation by petitioner in the sum of \$20,742.60 and a like amount of \$180,000.00 was

charged to the capital stock account with a result in capital deficit of \$23,095.56. No charge or entry was made, on the corporation's accounting records, to the Notes Payable Account due petitioner and the notes in the amount of \$200,000.00 were not cancelled. As of December 31, 1944, the balance sheet of petitioner showed a debit balance of the capital stock account of \$23,095.56 while the earned surplus account showed a credit balance of \$171,920.38, making a total net worth of \$148,824.82.

6. No income was reported by the petitioner on his individual income tax returns as a result of the credit of the corporation to his open account of \$180,000.00; but rather petitioner treated it as a return of capital, thus reducing the cost basis of his stock and postponing the profit on such distribution to the time when petitioner sold his capital stock or to when the corporation was dissolved and its assets distributed to its stockholders.

7. In May, 1947, the corporation paid the petitioner the sum of \$200,000.00 at which time the notes were still in the possession of the petitioner and were, upon such payment, surrendered to the corporation and cancelled. The accounting records of this corporation, prior to the payment, still reflected notes payable to the petitioner in the amount of \$200,000.00 until such payment in May, 1947, at which time said payment was offset against the notes payable account on the books of the corporation.

II.

Nature of the Controversy

This case involves the question of whether the payment to petitioner in May of 1947, of the sum of Two Hundred Thousand Dollars (\$200,00.00) from one Flexo Manufacturing Co., Inc., a corporation, was in payment of notes payable or a distribution of capital and taxable dividends to the extent of earnings and profits for that year.

III.

1. The findings of fact by the Tax Court are not supported by substantial evidence; all of the evidentiary facts are stipulated and uncontroverted to the effect that the payment by the corporation to petitioner of \$200,000.00 in 1947 was in form and substance repayment of loans and treated and regarded as such by the parties to the transaction.

2. The ultimate findings of the Tax Court, drawn from uncontroverted and stipulated facts, is erroneous in law.

3. The decision is wrong for the reason that it is in essence an attempt to reopen a tax year (1944) barred by the statute of limitations.

4. The said petitioner, being aggrieved by the findings of fact and conclusions of law contained in the said findings and opinion of the Court, and by its decision entered thereto, desires to obtain a review thereof by the United States Court of Appeals for the Ninth Circuit.

Wherefore, petitioner respectfully requests that the decision be reviewed by the United States Court of Appeals for the Ninth Circuit; that the said decision of the Tax Court of the United States be reversed and/or the case remanded and that the Clerk of the Tax Court of the United States give such notices and do such things as shall be necessary to perfect this petition.

/s/ ERIC L. BURTON,
Counsel for Petitioner.

Received and Filed June 7, 1956, T.C.U.S.

[Title of Tax Court and Cause.]

CERTIFICATE

I, Howard P. Locke, Clerk of the Tax Court of the United States do hereby certify that the foregoing documents, 1 to 16, inclusive, constitute and are all of the original papers and proceedings, including Joint Exhibits 1-A thru 10-J, attached to Stipulation of Facts, on file in my office as called for by the "Designation of Contents of Record on Review" in the proceeding before the Tax Court of the United States entitled: "C. H. Wentworth, Petitioner, vs. Commissioner of Internal Revenue, Respondent, Docket No. 51260," and in which the petitioner in the Tax Court proceeding has initiated an appeal as above numbered and entitled, together with a true copy of the docket entries in said Tax

Court proceeding, as the same appear in the official docket book in my office.

In testimony whereof, I hereunto set my hand and affix the seal of the Tax Court of the United States, at Washington, in the District of Columbia, this 3rd day of July, 1956.

[Seal] /s/ HOWARD P. LOCKE,
Clerk the Tax Court of the
United States.

[Endorsed]: No. 15207. United States Court of Appeals for the Ninth Circuit. C. H. Wentworth, Petitioner, vs. Commissioner of Internal Revenue, Respondent. Transcript of the Record. Petition to Review a Decision of the Tax Court of the United States.

Filed: July 16, 1956.

Docketed: July 24, 1956.

/s/ PAUL P. O'BRIEN,
Clerk of the United States Court of Appeals for the
Ninth Circuit.

[Title of Court of Appeals and Cause.]

PETITIONER'S STATEMENT OF POINTS

Petitioner intends to rely on the following points:

1. The findings of fact by the Tax Court are not supported by substantial evidence; all of the evidentiary facts are stipulated and uncontroverted to the effect that the payment by the corporation to Petitioner of \$200,000.00 in 1947 was in form and substance repayment of loans and treated and regarded as such by the parties to the transaction.

2. The ultimate findings of the Tax Court, drawn from uncontroverted and stipulated facts, is erroneous in law.

3. The evidentiary facts being fully stipulated by the parties before the Tax Court, it is a question of law as to whether the ultimate findings of the Tax Court herein are correct.

4. The decision is erroneous for the reason that it is in essence an attempt to reopen a tax year (1944) barred by the statute of limitations.

/s/ ERIC L. BURTON,
Counsel for Petitioner.

Affidavit of Service by Mail attached.

[Endorsed]: Filed July 31, 1956, U.S.C.A.

